2005 and Beyond

The Future of Trade, Development & International Institutions

By Dr Razeen Sally

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The Globalization Institute, Suite 58, 95 Wilton Road, London SW1P 3BL
Tel +44 (0)20 7043 2910
Fax +44 (0)20 7043 2911
www.globalizationinstitute.org

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Contents

1. Introduction 4

2. Whither the WTO? 5

3. PTAs as an alternative? 7

4. Liberalism From Below and the rise of China and India 9

5. Trade, aid, debt relief, UN reform: Global Salvationism in the new century 11

6. International relations: a post-Cold War, post-September 11th frame 14

7. Conclusion 16

Dr Razeen Sally is Senior Lecturer in International Political Economy at the London School of Economics and Political Science, where he has taught since 1993, and head of its International Trade Policy Unit. He is a Visiting Professor at the Institut D'Etudes Politiques (Sciences Po) in Paris, and at Tallinn Technical University in Estonia; and was a Visiting Senior Research Fellow at the Institute of Southeast Asian Studies, Singapore. From 1992-3, he was a Research Fellow at the European Institute of Business Administration (INSEAD) in Fontainebleau, France, and was a Visiting Assistant Professor at Dartmouth College in the USA in 1998. Dr Sally received his PhD from the LSE in 1992, having previously studied at the University of Frankfurt, the Free University of Berlin and the European University Institute in Florence, Italy.

He is also Director of Trade Policy at the Commonwealth Business Council in London and of the Commonwealth Business Council/Global Dimensions trade policy programme.

His research has focused on trade policy-making in developing and transitional countries, notably in Eastern Europe and East Asia, and on developing country participation in the WTO. He also writes on the intellectual history of political economy, especially the theory of commercial policy in the classical liberal tradition. Dr Sally has published *Classical Liberalism and International Economic Order: Studies in Theory and Intellectual History* (London: Routledge, 1998), and many articles and chapters in books on trade policy.

1. Introduction

The first few months of this year have seen a flurry of big, bold initiatives on trade, aid and development, especially with Africa in mind. Meanwhile, President Bush has audaciously nominated Paul Wolfowitz to head the World Bank. In Geneva, WTO members are trying to energise Doha-Round negotiations in the run-up to the Hong Kong Ministerial Conference in December. Outside Geneva, preferential-trade-agreement (PTA) initiatives continue to proliferate. Also grabbing headlines is the dramatic opening and global economic integration of first China and now India.

What is one to make of all this? What are the prospects for the Doha Round? What of the WTO's longer-term future? Does the new wave of PTAs bode well or ill for the multilateral trading system? What are the trade (and wider economic and foreign) policy implications of China's and India's integration into world markets? How viable are the new proposals on trade, aid and debt relief? Should "global governance" be strengthened to tackle these issues? How does all the above fit into the wider framework of international relations post-Cold War and post-September 11th?

These are the questions on trade, development and international institutions I address in terms of a 2005 stock-take, and a forward look to medium-term prospects.

2. Whither the WTO?

The July-2004 negotiating framework has whittled down the Doha-Round agenda into one that is better focused. But it is still vague on the key market-access issues (agriculture, services and non-agricultural goods); and the tough political decisions lie ahead. My guess is that not much will happen before the Hong Kong Ministerial, and that negotiations will take another couple of years, perhaps more.

What might an eventual deal look like? A big success would deliver substantially lower developed-country barriers to developing-country exports of agriculture and manufactures, stronger liberalisation commitments by advanced developing countries, and some marginal strengthening of WTO rules (e.g. on anti-dumping). As things stand, I think this scenario unlikely. At the other extreme, the round could fail altogether. In between lies modest success: limited liberalisation with hardly any rule-strengthening. This would keep the WTO show on the road, but it would leave the multilateral trading system in a weak and vulnerable state, increasingly hemmed in by a messy, discriminatory patchwork of PTAs. This is where I would put my money.

Ultimately, bringing the round to a successful conclusion and ensuring the WTO's longer-term relevance depend on tackling its systemic problems. A much expanded post-Uruguay-Round agenda has broadened sectoral coverage and gone much deeper into politically-sensitive domestic regulation. This has resulted in a loss of focus and a drift towards multiple and contradictory objectives. Hyperinflation of the membership has almost crippled decision making. The WTO has become much more politicised, buffeted by external criticism and with deep internal fissures. These are all symptoms of the "UN-isation" of the WTO.

To get the WTO out of its rut, its members need to do two things: restore focus on the core market-access agenda, i.e. progressive liberalisation; and revive effective decision making. The latter depends less on reforming formal procedures than on intergovernmental political will and informal decision making. This requires recognition of hard-boiled realities outside Geneva. About 50 countries account for well over 80 per cent of international trade and foreign investment. This comprises the OECD plus 20-25 developing countries that have been globalising rapidly and successfully. These are the ones with workable governments, sufficient

appreciation of own interests, negotiating capacity and bargaining power. They must take the lead.

Within this outer core, there is an inner core of "big beasts": the USA and EU, of course, but now joined by the increasingly influential developing-country majors, India, China and Brazil. Poorer and weaker developing countries – the vast majority of the membership – must of course be consulted and will exercise influence through the African, LDC, ACP and G90 groupings. But the plain fact is that their very marginal involvement in the world economy, bad-to-terrible governance and scarce negotiating resources make them unable to play more than a secondary and reactive role.

Even with the right dose of realism, there are, in my view, *increasing* limits to WTO-style multilateralism. The GATT was successful because it had (with hindsight) a slimline, relatively simple agenda, and small, club-like decision making, glued together by Cold-War alliance politics. Now, the WTO agenda is technically more complicated, administratively more burdensome and politically much more controversial; decision making is unwieldy in a general assembly with near-universal membership; and the unifying glue of the Cold War has dissolved.

For the WTO to work after the Doha Round, I think it needs to scale back ambitions and expectations. Market-access and rule-making negotiations should be more modest and incremental; and maybe trade rounds should become a thing of the past. There should be more emphasis on the unsexy, everyday tasks of improving policy transparency and administering existing rules better. Dispute settlement should not degenerate into backdoor lawmaking. Finally, core decision making should remain intergovernmental. Opening it to non-governmental actors would result in an agenda hijacked by organised minorities pursuing a plethora of conflicting objectives.

In sum, with more modest goals and proportionate means in a restricted intergovernmental setting, the WTO might best be able to serve what should be its core purpose: to be, at the margin, a helpful auxiliary to market-based reforms, especially in the developing world.

3. PTAs as an alternative?

PTAs among small clubs of like-minded countries can take liberalisation and pro-competitive regulatory reform further than would be the case in the WTO. This can in turn stimulate multilateral liberalisation. For PTAs to make economic sense, they must have comprehensive sectoral coverage, be consistent with relevant WTO provisions (in Article XXIV GATT and Article V GATS), and indeed go beyond WTO commitments. Liberalisation should be genuine and tangible, not bogus. There should be strong provisions for improving transparency in domestic regulation. And rules of origin should be as simple and harmonised as possible to minimise trade diversion and red tape. Overall, governments need to have a sense of economic strategy when entering into PTA negotiations – on choosing negotiating partners, assessing the costs and benefits of negotiating positions, and how they relate to the WTO and to the national economic-policy framework.

Unfortunately, strong, WTO-plus PTAs are the exception, not the rule. Most PTAs – especially those between developing countries – are weak and fall short of WTO provisions. They tend to be driven by foreign-policy concerns and gesture politics, with little sense of economic strategy. They involve patchy, quick-fix sectoral deals while sensitive areas are carved out. They hardly go beyond WTO commitments, deliver little, if any, net liberalisation and pro-competitive regulatory reform, and get tied up in knots of restrictive, overlapping rules of origin. Resource-intensive PTA negotiations also risk diverting political and bureaucratic attention from the WTO and from necessary domestic reforms. Finally, the sway of power politics can result in highly asymmetrical deals, especially when one of the negotiating parties is a major player.

Latin America and Africa now contain a hotchpotch of weak and partial PTAs. This is being replicated in south and east Asia, where PTA initiatives have mushroomed since 1999. Very few of the latter look like delivering strong, clean agreements. The heart of the matter is that cross-border commerce within these regions, as elsewhere in the developing world, is throttled by the protectionist barriers that developing countries erect against their equally poor or even poorer neighbours. Will new PTAs make a big dent in these barriers and thereby spur regional economic integration? I doubt it. To use a Texanism, many, perhaps most, PTAs are "all hat and no cattle".

Going about PTAs the wrong way – negotiating weak agreements that deflect attention from sensible unilateral reforms and the WTO – could easily lead to a world where most international trade would be governed by a bewildering array of market-distorting preferences. Then the cornerstone of the multilateral trading system, the principle of non-discrimination, would become more an abstraction than concrete reality. That has profound political as well as economic ramifications.

4. Liberalism From Below and the rise of China and India

It is customary to look first to the WTO, or now to PTAs, or to a combination of the two, to advance the liberalisation of international commerce. This "liberalism from above" overlooks fundamental lessons from theory, history and the world around us today. Compelling political and economic arguments favour *unilateral* liberalisation, with governments freeing up international trade and flows of capital and labour independently, not via international negotiations. As any student of trade economics knows, welfare gains result directly from *import* liberalisation, which replaces comparatively costly domestic production and reallocates resources more efficiently. Such gains come quicker through own, unconditional liberalisation than through protracted, politicised and bureaucratically cumbersome international negotiations. This Nike strategy ("Just Do It!") makes political sense too. Rather than relying on one-size-fits-all international blueprints, governments have the flexibility to initiate policies and emulate better practice abroad in experimental, trial-and-error fashion, tailored to specific local conditions.

Observers often forget that the recent trade-policy revolution in the developing world has come more "from below" than "from above". The World Bank estimates that, since the 1980s, about two-thirds of developing-country trade liberalisation has come about unilaterally. True, many governments liberalised reluctantly as part of IMF and World Bank structural adjustment programmes. But the strong and sustained liberalisers have gone ahead under their own steam, without the need for much external pressure.

The big news in globalization today, and probably for the next few decades, is the rise of Asia, and within it the dramatic opening of first China and then India. China's massive trade-and-investment liberalisation programme over the past decade is the biggest the world has ever seen. Most of this was done unilaterally, not through international negotiations, and *before* WTO accession. China's extremely strong WTO commitments, and its very pragmatic, businesslike and constructive participation in the WTO since accession, are more the consequence than the cause of its sweeping unilateral reforms.

China is in many ways today what Britain was in the second half of the nineteenth century: the unilateral engine of freer trade. It is probably spurring a pickup in trade-and-FDI liberalisation elsewhere – notably in India. There market-based reforms since 1991 have proceeded more slowly than in China, but have been very substantial by previous Indian standards. Recently India has accelerated its unilateral liberalisation of tariffs and FDI. Would this have happened, or happened as fast, if China had not concentrated minds? Probably not.

The point I wish to emphasise is this. Freer trade in the early twenty-first century, and modern globalization more generally, are happening more "from below" than "from above". Their engine, now to be found in Asia, particularly in China, is bottom-up liberalisation and regulatory reform that spreads through competitive emulation, like ripples and waves across seas and oceans. This process is not driven by international institutions. Indeed, as I have argued earlier, the WTO and FTAs have considerable and perhaps increasing limitations. At best they can be helpful auxiliaries to national market-based reforms. But their importance should not be exaggerated.

5. Trade, aid, debt relief, UN reform: Global Salvationism in the new century

This seems to be the year for grand initiatives on Africa. The biggest and boldest is the UN Report on the Millennium Development Goals, coordinated by Jeffrey Sachs. But not far behind are Tony Blair's agenda for the G8 and the Africa Commission Report. All three head in the same direction. The Africa Commission Report calls for doubling and possibly tripling aid by 2015, and for the cancellation of all multilateral debt. On trade, it enjoins developed countries to bring down their protectionist barriers in agriculture, e.g. by abolishing trade-distorting subsidies to cotton and sugar, offering duty- and quota-free access to all exports from least-developed countries, and simplifying rules of origin.

These initiatives are generally commendable for focusing the world's attention on Africa's dire problems. As for the specifics: first, the proposals on trade are wholly welcome. It would be good news indeed if the extra pressure exerted were to goad developed countries to make serious concessions on agriculture in the Doha Round. It has to be said that African countries would gain most if they were to promote further trade and other market-based economic reforms at home, but this should not be a condition for much-delayed developed-country liberalisation. Second, large-scale debt forgiveness is a good idea, but it should be conditional on governments spending the extra resources appropriately. Unconditional debt relief combined with an increase in aid, on the other hand, would be excellent news for more white-elephant projects and the president's Swiss bank account. Third, there are welcome noises on making aid transparent, predictable, untied and conditional on good governance in recipient countries.

Now for my scepticism. A half-century of aid has been an almost unmitigated disaster. Its politics and psychology are utterly corrupting. It has weaned large, arbitrary and corrupt governments while crowding out markets and individual economic freedom. Hence a large and sudden increase in aid now is a bad idea for all the old reasons. It will simply overwhelm the supply capacities of already weak and dysfunctional governments. Making it conditional on good-governance criteria is wishful thinking. Given the sums and the short time-frame discussed, it is bound to provide more incentives for bigger, wasteful, corrupt and intrusive government. Only the utterly naïve or wilfully disingenuous can aver that good governance will result from aid

that accounts for up to two-thirds of government spending and 20-30 per cent of national income (as is proposed in the Sachs Report). True, there is some evidence to show that well-targeted aid can work in better-governed countries. But there are very few of these in Africa; and claims made on behalf of some of the "poster-children", such as Uganda and Tanzania, are too confident and premature – and conveniently suit the interests of those in the aid business.

The failure of the state, not of markets, is central to the African tragedy. A big, aid-induced investment push risks making state failure worse rather than helping to build up viable market societies plugged into the world economy. It is a silly and dangerous idea. The Sachs Report, with its big-spending hubris and breathtaking political naivety, should get the Nobel Prize for pottiness and recklessness.

This is not an argument for getting rid of aid altogether. Rather it would be better to take the existing volume of aid and thoroughly restructure it so that it works better to meet a smaller set of limited, realistic goals. Aid should be redirected from middle-income countries that have good access to capital markets to low-income and especially least-developed countries that lack that access. Then it should go to better-governed countries, but carefully and gradually according to clearly defined and well-monitored criteria. There is a case for more aid for specific programmes with clear, precise goals and appropriate mechanisms, e.g. to combat HIV/AIDS and tropical diseases, and meet WTO commitments. Aid should be in the form of grants rather than loans. It should use price-based market mechanisms. And it should bypass governments and deal directly with private organisations on the ground as much as possible.

Underlying these initiatives, especially on aid, is a world-view that David Henderson, the former chief economist of the OECD, calls Global Salvationism or Deliverance From Above. It afflicts those who call for stronger global governance. Global solutions are to be provided by concerted co-operation involving governments, international organisations, Big Business, trades unions and NGOs. The UN system is, of course, front and centre in this scheme. The Sachs Report is suffused with these ideas, as is Kofi Annan's new blueprint for UN reform.

The notion that a global market economy can be planned from above in this way is profoundly misguided. It is top-down bureaucratic thinking, a sort of soft international central planning for the post-Soviet age. It is Orwellian Goodthink for the twenty-first century. To adapt a Bushism, it misoverestimates the importance and effectiveness of international institutions, and

misunderestimates their failings, such as self-serving bureaucracy and misguided meddling. Rather, successful development, like good trade policy, emerges from below – from national policies and institutions that support markets, and from individuals and enterprises that take advantage of economic freedoms and market incentives. International institutions with limited goals and commensurate means can help at the margin. This, rather than an impossibly ambitious global-governance agenda, is what the World Bank, IMF and WTO should promote.

Seen in this light, Paul Wolfowitz's nomination to lead the World Bank could turn out to be the right and inspired choice, following on the heels of John Bolton's nomination as US ambassador to the UN. Both are political realists who appreciate the power of the USA to provide the global *Pax* and promote a liberal international economic order. Both are sceptics of international organisations and have no time for global-governance chatter. Now Mr Wolfowitz should marry his political realism with economic liberalism. The World Bank should promote markets and economic freedom in the developing world, but with more modest, pared-down means and ends. It should emphasise information-sharing, the exchange of ideas, policy surveillance and technical assistance. But its power of the purse through project and programme lending should be overhauled and kept within strict limits. And global-governance fantasists should be told where to get off.

6. International relations: a post-Cold War, post-September 11th frame

So far I have placed trade-and-development in the frame of economic policy; and I have stressed the primacy of national economic policies and institutions. Now it is time to link up to foreign policy and international politics, for this frame is also indispensable for trade-and-development. A reasonably stable international political order is the categorical imperative for economic development. Without the global *Pax* – an orderly framework for international relations – there can be no security for national and international commerce.

Trade-and-development must work with the grain of wider geopolitical realities. These have changed since the end of the Cold War, and more recently after September 11th. No serious challenge exists to US leadership abroad; Europe and Japan are internally sclerotic and externally pusillanimous; other powers are on the rise, notably China, India and Brazil; the transatlantic alliance is no longer the fulcrum of international relations; and politics and economics are shifting inexorably in an Asia-Pacific direction.

The one constant in this shifting political template is US leadership. For the foreseeable future, the USA will remain the indispensable anchor for global security, prosperity and freedom – far more important than any international organisation or international treaty. It is vital that it leads from the front: in securing the global *Pax* against systemic threats; in helping to rescue and reconstruct failed states; in maintaining open and stable international financial markets; and, not least, in breaking down barriers to trade and the movement of capital and people across the world. Above all, the US must lead by example, setting the standard for liberal economic policies worldwide by what it does at home. This includes untying existing knots of domestic protectionism.

US leadership will be exercised on several tracks: unilaterally; bilaterally and regionally, especially in relations with other powers; and multilaterally through international institutions. Daunting domestic and external obstacles stand in the way of the enlightened exercise of US power and influence abroad. But robust US leadership is *sine qua non* to the future relevance and workability

of international institutions such as the WTO, IMF and World Bank. They would be lame and sidelined without it.

7. Conclusion

To sum up: I am pessimistic about the prospects for a fresh wave of liberalisation through the WTO and other international institutions. I think most of the new – or, more accurately, new-old – ideas on aid are wrong. More generally, top-down global-governance prescriptions are profoundly misguided. But I am reasonably optimistic that further liberalisation, and with it the spread of economic globalization, will come from a different route: from below through unilateral example-setting and competitive emulation. Its engine is China today, and perhaps China plus India the day after tomorrow.

These trade and wider economic policy trends must also be seen in the bigger picture of international politics. Here the defining features are US leadership – now more important than ever – and relations between the USA and other powers, especially the rising powers in Asia-Pacific, and above all China. International institutions and the transatlantic relationship will matter less, though they are not unimportant.

Overall, this is good news for developing countries with market-based policies and institutions. Going further with liberalisation and related regulatory reforms, restructuring the state so that it does fewer things better, widening the space for individuals' economic freedoms – all this will allow countries to take maximum advantage of globalization, raise real incomes, make serious inroads into poverty and generally improve human welfare. This is already happening fast in Asia, but less so elsewhere, and not at all in most of Africa.

The African problem is the failure of the state. The old solutions of aid and policy driven by international organisations, in alliance with venal and thuggish local postcolonial elites, have failed. Short of US-directed liberal imperialism, I am not sure what the solutions are. In any case, the USA, unlike Britain in the nineteenth century, is not interested in, and perhaps not capable of, a liberal-imperial role in Africa. This leaves a real dilemma.